

## Internal Revenue Service

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Department of the Treasury  
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### Legend

Taxpayer =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Year 1 =

Year 2 =

State A =

Dear :

This letter responds to your authorized representative's letter dated September 14, 2006, requesting a ruling concerning the federal income tax consequences of a consummated transaction. Additional information was submitted in letters dated November 29, 2006 and December 12, 2006. The information submitted for consideration is summarized below.

The rulings contained in this letter are predicated upon the facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the materials submitted in support of the request for a ruling. Verification of the information, representations, and other data may be required as part of the audit process.

### SUMMARY OF FACTS

Taxpayer is a privately held State A corporation. Taxpayer files its corporate federal income tax return on a calendar year basis and is an accrual basis taxpayer.

Taxpayer began incurring losses and generated a net operating loss carryforward in its tax year ending Year 1. On Date 1, the Taxpayer filed a voluntary petition in bankruptcy under chapter 11 of the Bankruptcy Code. On Date 2, the bankruptcy court confirmed the Taxpayer's plan of reorganization. The reorganization qualified as a tax-free reorganization described in I. R.C. section 368(a)(1)(E). The reorganization of Taxpayer entailed the issuance of new Taxpayer common stock to prior creditors of Taxpayer, in satisfaction of their claims.

Effective on Date 4, Taxpayer emerged from bankruptcy under the plan of reorganization, which resulted in the cancellation of the existing common stock of the Taxpayer, and the distribution of new common stock of the Taxpayer to creditors and to new investors of Taxpayer. On Date 4, investors contributed cash to Taxpayer in exchange for voting preferred stock of Taxpayer. On Date 5 and Date 6, the Taxpayer obtained working capital loans from stockholders and issued them promissory notes with convertible warrants. None of the convertible warrants were ever exercised by the stockholders.

On Date 7, the Taxpayer obtained additional working capital loans from lenders. As a condition of the bank to grant consent to these new working capital loans (Date 7 loans), the principal amount of the Date 6 Notes were required to be converted to stock effective as of Date 7. The Taxpayer is requesting a ruling be issued stating that the testing period for determining whether a subsequent ownership change has occurred begins on Date 3, the first day following the confirmation of the bankruptcy reorganization plan on Date 2.

### LAW

Section 382 of the Internal Revenue Code imposes a limitation on the utilization of net operating loss carryforwards against future taxable income of any new loss corporation following the ownership change.

Section 382(k)(1) defines “loss corporation” as a corporation entitled to use a net operating loss carryover or having a net operating loss for the taxable year in which the ownership change occurs.

When a shift in ownership occurs, the corporation is required to calculate the percentage of stock owned by any shareholder holding 5 percent or more of the loss corporation’s stock after the transaction over the lowest percentage of stock owned by such shareholder at any time during the testing period. If all shareholder’s holding five percent or more of the loss corporation’s stock after the transaction have increased their percentage of stock owned by 50% or more during the testing period, an ownership change has occurred for purposes of determining whether a section 382 limitation applies. I.R.C. § 382(g)(1).

Generally, the testing period for determining whether an ownership change has occurred is the three-year period ending on the day of any ownership shift involving a five percent shareholder. I.R.C. § 382(i)(1). However, there is an exception to the three-year period when there has been more than one ownership change within the three-year period.

If there has been a recent ownership change under section 382, the testing period for determining whether a second ownership change has occurred does not begin before the first day following the “change date” for such earlier change. I.R.C. § 382(i)(2). The “change date” is the date of the owner shift or the reorganization, whichever is later. Treas. Reg. § 1.382-2T(f)(19). Therefore, there is to be no overlapping of testing periods. The new testing period begins on the day after the prior change date. Treas. Reg. § 1.382-2T(d)(2).

Section 382(l)(5) provides an exception for limiting a net operating loss carry forward when a corporation is under the jurisdiction of the court in a title 11 or similar case. For this exception to apply, the pre-change shareholders and qualified creditors of the old loss corporation must meet the requirements of section 1504(a)(2), determined by substituting “50 percent” for “80 percent” each place it appears. Therefore, the pre-change shareholders and qualified creditors must own at least 50% of the total voting power and 50% of the total value of the stock of the new loss corporation after the ownership change.

Treas. Reg. § 1.382-9(d)(1) defines a qualified creditor as a beneficial owner of qualified indebtedness of a loss corporation immediately before an ownership change. A qualified creditor owns stock of the new loss corporation as a result of being a qualified creditor only to the extent that the qualified creditor receives stock in satisfaction of

qualified indebtedness in a transaction ordered by the court or pursuant to a plan approved by the court in a title 11 or similar case.

Treas. Reg. § 1.382-9(d)(2) states that indebtedness is qualified if it has either been owned by the same beneficial owner at least 18 months before the date of the title 11 filing or arose in the ordinary course of the trade or business of the loss corporation and has always been owned by the same beneficial owner.

However, if another ownership change occurs within the 2 years immediately following the bankruptcy reorganization ownership change, the section 382 limitation with respect to the second ownership change is zero, causing the loss corporation to lose all of its net operating loss carryforwards. I.R.C. § 382(l)(5)(D).

### REPRESENTATIONS

The Taxpayer has made the following representations with respect to the consummated transaction:

- (1) Taxpayer is a loss corporation within the meaning of section 382(k)(1) of the Internal Revenue Code.
- (2) On Date 2, the bankruptcy court confirmed the taxpayer's plan of reorganization. Prior to the reorganization, the creditors of the taxpayer did not own any of the stock of the taxpayer loss corporation. As a result of the reorganization, the qualified creditors, that became greater than 5% shareholders as a result of the reorganization, owned greater than 50% of the total value of the stock of the new taxpayer loss corporation.
- (3) Taxpayer represents that the pre change shareholders and qualified creditors of the Taxpayer old loss corporation own greater than 50% of the total voting power and 50% percent of the total value of the stock of the Taxpayer new loss corporation.
- (4) Taxpayer has analyzed and determined which creditors were qualified creditors of the Taxpayer as defined by Treas. Reg. § 1.382-9(d)(1). Qualified creditors received stock in satisfaction of qualified indebtedness as a result of the court approved plan of reorganization. Indebtedness was determined to be qualified indebtedness if it had either been owned by the same beneficial owner at least 18 months before the date of the Title 11 filing or arose in the ordinary course of business of the Taxpayer loss corporation and has always been owned by the same beneficial owner.
- (5) Prior to the confirmation of the bankruptcy plan on Date 2, the Taxpayer has not had an ownership change as defined in section 382(g)(1).

- (6) The Taxpayer has filed its Year 2 federal income tax return and the statute of limitations for making an assessment of income tax is open for that year.
- (7) The Taxpayer had no warrants or options outstanding the day following the bankruptcy confirmation.

### RULINGS

Based solely on the information submitted and the representations set forth above, we rule as follows:

- (1) Confirmation of the bankruptcy plan on Date 2 will result in an ownership change of Taxpayer pursuant to I.R.C. Section 382(g), because of a greater than 50 percent change in the ownership of Taxpayer stock by 5% shareholders of Taxpayer.
- (2) Pursuant to section 382(i)(2) and Treas. Reg. § 1.382-2T(d)(2), the testing period for determining whether the lenders' conversion of the Date 6 Notes into stock of the Taxpayer and the investors' receipt, on Date 4, of voting preferred stock of Taxpayer in exchange for cash constitutes a subsequent ownership change of Taxpayer, begins on Date 3, the first day following the confirmation of the bankruptcy reorganization plan on Date 2.

### CAVEATS

No opinion is expressed about the tax treatment of this consummated transaction under other provisions of the Code or regulations or the tax treatment of any conditions existing at the time of, or the effects resulting from, the consummated transaction that are not specifically covered by the above ruling. In particular, no opinion is expressed regarding whether the lenders' conversion of the Date 6 Notes into stock of the Taxpayer and the investors' receipt, on Date 4, of voting preferred stock of Taxpayer in exchange for cash subsequent to the confirmation of the bankruptcy reorganization plan constitutes an ownership change of Taxpayer within the meaning of section 382(g). In addition, no opinion is expressed whether Taxpayer's plan of reorganization qualifies as a tax-free reorganization pursuant to section 368(a)(1)(E). Furthermore, we are expressing no opinion whether the exception provided in IRC Section 382(l)(5) was met with respect to the ownership change occurring because of the bankruptcy court plan confirmation on Date 2.

### PROCEDURAL STATEMENTS

This ruling letter is only directed to the taxpayer requesting it. Section 6110(k)(3) of the Internal Revenue Code provides that it may not be used or cited as precedent.

A copy of this ruling letter must be attached to the federal income tax return of each taxpayer involved for the taxable year in which the transaction covered by this ruling letter is consummated. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the ruling letter.

In accordance with the power of attorney on file with this office, the original letter is being sent to the taxpayer and a copy to the taxpayer's authorized representative.

Sincerely,

Steven J. Hankin

Steven J. Hankin

Senior Technician Reviewer, Branch 6  
Office of Associate Chief Counsel  
(Corporate)